No. 21795

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ESTATE OF EUGENE L. FREELAND, Deceased, by SECURITY FIRST NATIONAL BANK, a national banking association, Executor, and VERA GOOD FREELAND, by L. N. TURRENTINE, Conservator,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONERS' OPENING BRIEF.

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Jurisdiction.

This is an appeal from a decision of the Tax Court of the United States. The taxes involved are income taxes, and the taxable years involved are 1956 through 1961, inclusive. The decision of the Tax Court (Doc. No. 5181-64 in that Court) was entered December 30, 1966, and the petition for review thereof by this Court was filed and served March 24, 1967. [Tax Court General Docket, p. 3.] Jurisdiction is asserted under I.R.C. 1954, Sections 7482, 7483.

Statement.

The controversy involves the proper determination of the liability of Eugene L. Freeland and his wife, Vera Good Freeland, for Federal income taxes for the

calender years 1956 through 1961. They filed joint returns for those years. Mr. Freeland, hereinafter referred to as "Freeland," died December 3, 1966.

There is a single issue, whether the gain derived by Freeland from the sale by him on November 26, 1956, of his interest in a partnership, Sam Berger Investment Company, hereinafter referred to as "the partnership," was capital gain or ordinary income. The presence of the same issue in the several years involved herein results from the fact that Freeland reported that gain on the intallment basis.

The sole asset of the partnership upon the sale by Freeland of his partnership interest was a parcel of raw, unsubdivided land, 4200 acres in extent, located in San Diego County, California. Because of the provisions of Section 741 of the Internal Revenue Code of 1954, the gain by Freeland on the said sale of his partnership interest was capital gain unless the said parcel of land was then held by the partnership, within the meaning of Section 1221(1) of that Code, for sale to customers in the ordinary course of its trade or business. The facts relevant to a determination of whether the land was then so held are as follows:

From 1923 and up to the time of his death Freeland was a full-time civil and structural engineer living and working in San Diego County, California. He was licensed to practice by California and certain other states. During the years involved herein he was a senior member of a civil engineering firm and a structural engineering firm. [TC 3.][1] His reputation was excellent. [TC 4.]

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[1]The reference is to pages in the "Memorandum Findings of Fact and Opinion" of the Tax Court contained in the record.

In 1953 Freeland was asked by one of his land developer clients, Kensington Heights Company, to help find a buyer for a parcel of raw, unsubdivided land in San Diego County known as the "Waring Ranch" property. That property had originally consisted of 6200 acres. In 1951 400 acres were annexed to the City of San Diego and subsequently sold by Kensington. An additional 1300 acres were annexed in 1952 or 1953 and sold by Kensington to Bollenbacher & Kelton, Inc., subdividers and developers. [TC 4.] In 1953 Kensington undertook to have the remaining 4500 acres annexed. Those remaining 4500 acres contained a lake, some canyons, and a mountain rising 1100 feet above the surrounding terrain. In connection with the proceeding for annexation, Freeland's civil engineering firm prepared a master plan map of the area, which indicated the lines along which development might feasibly proceed. The City annexed the 4500 acres in December, 1953. It was that area for which Kensington, shortly before the annexation, sought Freeland's help in finding a buyer. [TC 5.]

For this purpose Freeland contacted several of his land-developer clients, including one Carlos Tavares, hereinafter referred to as "Tavares," but they were not interested because they thought that development and subdivision of the area was too remote in time. [TC 5, 18; Tavares dep. pp. 4-5.] San Diego County was growing rapidly, however, and that growth was resulting in a continuing and substantial appreciation in real estate values. [TC 3-4.] In August, 1954, Freeland joined with another of his clients, one Sam Berger, hereinafter referred to as "Berger," in the acquisition

of the land. [TC 5.] For that purpose they formed the partnership above named, Sam Berger Investment Company.[2] [TC 5, 11.]

The purchase price was $4,676,666.66, $100,000.00 down and the balance in 20 annual installments. [TC 6.] Partial releases from the trust deed were provided for, 150 acres against each annual installment paid. [TC 6.] The partnership was also required, under a provision inserted in the purchase agreement by Kensington, to deposit $200,000.00 in escrow to be disbursed for off-site improvements upon instructions from Kensington. [TC 6, 26.] Such improvements include (a) bringing utilities up to the property, and (b) installing on the property, if it is in the path of future development, utilities large enough to meet the needs not only of the property on which installed, but also those of such future development. In approving a proposal for such improvements the City considers the development in terms of overall plans for the surrounding area. [TC 15.] The cost of such improvements in excess of that required by the property on which installed is generally paid by the City. [TC 6-7.]

Of the down payment of $100,000.00 Freeland provided $70,000.00, and Berger $30,000.00. [TC 7.] The $200,000.00 deposit also required by Kensington, for off-site improvements, the partnership obtained, after several unsuccessful efforts to obtain it from other sources [TC 8], from a joint venture of corporations engaged in land development known as "County Club Park." As consideration therefor the partnership gave

[2]The partnership is referred to in the findings and opinion of the Tax Court as "SBIC." [TC 9.]

(a) to two investors in that joint venture, Jack Barenfeld and Samuel Glaser, a 20% interest in the partnership [TC 8, 11]; and (b) to a newly created and wholly owned subsidiary of that joint venture, Lake Murray Development Company, a corporation, hereinafter referred to as "Lake Murray,"[3] an option to buy, at $2,000.00 per acre, 500 acres out of an 800-acre portion of the 4500 acres being purchased from Kensington. [TC 8-9.] As the partnership was now divided, Freeland held 32% as general partner; a designee of his, Margaret C. Lowthian, 8% as limited partner; Berger 20% as general partner; two designees of his, being a trust for each of his two sons, as limited partners, 10% each; and Barenfeld and Glaser, under the name of "Lake Murray Trust No. 1," as limited partners, the remaining 20%. [TC 11.]

Under the option agreement so created between the partnership and Lake Murray, the partnership agreed to reimburse Lake Murray for expenses in excess of a stipulated maximum per lot cost of development, any saving below such cost belonging as profit to the partnership; and the partnership also agreed to be liable for all off-site improvement costs in excess of the $200,000.00 deposited in escrow for that purpose. [TC 10.] The partnership's purchase escrow closed October 26, 1954. [TC 9.] On November 4, 1954, Lake Murray exercised its option to the extent of 3.19 acres for the purpose of building model homes, and proceeded to make the aforesaid off-site improvements. [TC 14.]

The off-site improvements were made to the 500 acres subject to Lake Murray's option. [TC 16; testimony

[3]Referred to in the Tax Court's findings as "LMDC." [TC 8.]

of Eugene Francis Cook, Tr. 294-295.] The principal aim in construction of these facilities was to provide adequate facilities for the 500 acres with minimum damage to the remaining 4000 acres. [TC 16.] Although the total deposit required by Kensington was only $200,000.00, the average cost of off-site improvements is $1,000.00 per acre. [Tavares dep. pp. 16-17.]

Berger was the initial president of Lake Murray. [TC 8.] Freeland, however, had no interest in that corporation as either investor, director or officer. [TC 9.] He only rendered to it his consulting services as land engineer, for which it was agreed he would receive, in addition to any other engineering fees, $25.00 per lot on the first 2000 lots. [TC 13.] The 500 acres were estimated to produce 2200 to 2400 lots. [TC 15.] The agreement to pay Freeland an engineering fee of $25.00 per lot on the first 2000 lots was contained in the partnership's partnership agreement, which was reduced to writing as a formal limited partnership agreement on November 23, 1954, and to which Lake Murray was not a party. [TC 10, 13; Exs. 15, 18.]

Early in 1955 differences arose between the partnership and Lake Murray. [TC 16.] On February 3, 1955, the partnership, by Freeland, and Freeland individually, filed formal notices of non-responsibility for costs being incurred on the property by Lake Murray. [Stipulation, par. 19, Exs. 24, 25.] As of July 1, 1955, the option agreement between the partnership and Lake Murray was radically amended. The price per acre after the first 250 acres was cut to $1,800.00. [Ex. 27, par. 2.] The fee of $25.00 per lot to Freeland, previously payable by the partnership under its partnership agreement, was now made payable under the amended

option agreement by Lake Murray. [Ex. 27, par. 18.] More importantly, the lot and off-site improvement cost guarantees by the partnership contained in the original agreement were eliminated [TC 17], and the partnership was agreed not to be liable on any bond for the development of either on-site or off-site work relating to the development of the 500 acres. [Ex. 27, par. 11.] The entire scheme of liability and gain of the partnership in connection with the activities of Lake Murray was eliminated. [Ex. 27.]

Immediately thereafter, in July and August of 1955, Lake Murray further exercised its option to the extent of 146.93 acres, and commenced development of its first regular unit of homes. [TC 16.] By the summer of 1955, however, Lake Murray also developed financial difficulties. An attempt by Berger to obtain more saleable land by substitution of land in the foothills of the mountains failed because the cost of off-site improvements there would have been prohibitive. [TC 17.] Lake Murray was not able to overcome its difficulties. On May 4, 1956, it became insolvent. It then assigned to Phoenix Insurance Company of Hartfort all of its assets except its remaining option to the extent of 200 acres. [TC 17.][4] The assets assigned thus included the option to the extent of 150 acres, and this Phoenix exercised on August 6, 1956. [TC 18; Stipulation, par. 27.] On August 10, 1956, Berger, because he himself, individually, was in financial difficulties, sold the 40% interest in the partnership held

[4]Lake Murray, thereafter assigned that retained interest in the option to certain of the investors in the said "Country Club Park" joint venture in consideration of the cancellation of claims for advances. See Findings 42(a) in the decision in *Morse v. United States,* referred to below at p. 10.

by himself and his two trusts to a new group headed by Tavares. [TC 18.] Tavares then approached Freeland, offering to take him into his group. Freeland refused that offer. [TC 18.] Tavares also tried to buy Freeland's interest but had difficulty even in getting a price. [Tavares dep., pp. 10-12.] Finally Freeland sold his 32% interest, which had cost him $70,000.00, to the Tavares group, on November 26, 1956, for $730,000.00. At the same time Margaret C. Lowthian sold her 8% interest to the Tavares group. [TC 18.]

The partnership never held any other land. [TC. 20.] It never advertised, promoted, or otherwise engaged in active efforts to solicit buyers for, or developers of, its land, either directly or through agents. [TC 19.] Freeland, on behalf of the partnership, refused several unsolicited offers to purchase portions of the acreage not covered by the Lake Murray option. [TC 19]. The partnership's only land transactions were those it was required to carry out, specifically the sales to Lake Murray under its option, a sale of a fractional acre to the telephone company, a sale of four acres to the City for a reservoir site as required by Kensington when the partnership purchased the land, and a grant of options for school sites to the San Diego School District pursuant to the conditions of the annexation. [TC 20.] Freeland individually never, at any time material, was a dealer in real estate or held any land for sale to customers in the ordinary course of his trade or business. [TC 19.]

San Diego County entered into a period of substantial population growth after World War II. [Stipulation, par. 3, p. 3.] As already noted above, it experienced rapid growth prior to and during the years here

in question. [TC 3-4.] In the decade 1930-1940 the population of the County increased 38%; in the decade 1940-1950 the increase, over 1940, was 93%; and in the decade 1950-1960 the increase, over 1950, was 86%. (California Statistical Abstract, p. 11, Table B-5.) As to the City itself, the corresponding percentages were 37, 64 and 71. (Statistical Abstract of the United States, 1950, p. 59, 1966, p. 21.) This growth of San Diego resulted, as also noted above, in a continuing and substantial appreciation in real estate values. [TC 4.] Tavares, the largest developer in the area [Tavares dep., pp. 12-13]. built six or seven thousand homes during 1954-1956 [*Ibid.* p. 7], and sold as many lots in one year to different builders. [*Ibid.* p. 13.] During that period also, the firm of Bollenbacher & Kelton, which, as noted above, had acquired 1300 acres of the Waring Ranch property in 1952 or 1953, was doing quite well. [*Ibid.* p. 7.] In 1954 the 4500 acres of that property then being acquired by the partnership was fairly worth seven to eight hundred dollars per acre for eventual development [*Ibid.* pp. 18-19], and that figure, or even a thousand dollars per acre, was a good price for investment. [*Ibid.* p. 21.] The proof of the actual appreciation in value of that property during 1954-1956 was what Tavares paid for it. [*Ibid.* p. 14.]

Freeland reported his gain on his sale to the Tavares group as capital gain, on the installment basis. [TC 20.] The Commissioner examined his return for 1956, specifically questioned his treatment of the gain as capital gain, and examined the books and records of the partnership as well as many official City records. Thereafter, on September 19, 1958, the Commissioner, by

notice to Freeland, upheld the latter's treatment of the gain as capital gain. Almost four years later, however, on April 26, 1962, the Commissioner reopened that examination, and, by the statutory deficiency notices involved herein, on July 29, 1964, determined that the gain was ordinary income. This determination the Commissioner followed for subsequent years. The Tax Court sustained the Commissioner's determination that the gain was ordinary income, not capital gain, and also his reopening of the examination for 1956. [TC 21.]

The said reopening by the Commissioner of his examination was done because of the large amount involved and "in the interest of being consistent" with the cases of other partners in the partnership, handled by another agent. [TC 21.] The latter cases wound up in a test case of one of the partners (a transferee of .723% out of the 20% of the said "Lake Murray Trust No. 1") in the United States Court of Claims, *Morse v. United States,* 371 F. 2d 474, decided January 20, 1967. We do not cite that case in the argument portion of this brief only because a motion for reconsideration filed by the government is pending there. It is very significant, however, that that motion was based solely on the decision of the Tax Court here, despite the fact that the reopening here was done for the purpose, the express purpose, of being consistent with the group of cases involved there.

As noted above, an additional reason given by the Commissioner for the reopening was the large amount of tax involved here. The total amount of the deficiencies asserted, without including interest, for the years 1956 through 1961, is $239,469.78. [TC 2.] Accu-

mulated interest would add approximately $126,500.00, so that the actual total would be more than $365,000.00. This approximately equals the total assets in the decedent Freeland's estate, as shown by the total inventory filed in that estate.[5]

Specification of Errors.

1. The Tax Court erred (in its opinion, at p. 23) in finding that the plans of the Sam Berger Investment Company "at the time of acquisition of the property continued to govern its subsequent activities."

2. The Tax Court erred in holding that, at the time of the sale by Freeland of his partnership interest in Sam Berger Investment Company (November 26, 1956), the real property of said company was held by it for sale to customers in the ordinary course of its trade or business, within the meaning of I.R.C. 1954, Sec. 1221(1).

Summary of Argument.

The result here depends on the purpose for which the Sam Berger Investment Company, herein referred to, as above, as "the partnership," held its property, vacant land; and that purpose is to be determined as of the time when Freeland sold his interest in the partnership. The Tax Court determined that purpose to be sale to customers in the ordinary course of

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[5]The docket number of the estate in San Diego is No. 84374. The statement above as to the condition of the estate is made on the basis of judicial notice. As to judicial notice of documents required by law to be filed in another court proceeding, see *Donnelly v. U.S.* (C.A. 9, 1953), 201 F. 2d 826, *Sternberg v. Moran* (C.A. 2, 1952), 196 F. 2d 1002, *Nongard v. Burlington County Bridge Commission* (C.A. 3, 1956), 229 F. 2d 622, *Martinson v. U.S.* (D. Minn., 3rd Div., 1958), 162 F. Supp. 305, and *U.S. Ex Rel. Peters v. Carson* (W.D. Pa., 1954), 126 F. Supp. 137.

trade or business. That court, however, conceding the absence, from the activities of the partnership, of the normal criteria supporting such a purpose, relied here instead on the activities of another entity, Lake Murray Development Company, herein referred to, as above, as "Lake Murray."

This reliance by the Tax Court is based on its position [TC 29-31] that the two entities, the partnership and Lake Murray, were "interlocking." This position, however, at best vague and speculative, fails because: (1) it is inconsistent with the Tax Court's own findings, especially as to the severe breach detailed in the statement above, which early occurred between the two entities and was never healed; (2) the statutory provision involved relates only to property *held* for sale, but the partnership here never made a single sale of property held by it which it at any time had a choice to make or not to make, nor did it ever attempt to make one; (3) if, in any case, the "interlocking" of the partnership and Lake Murray charged by the Tax Court existed to begin with, it soon terminated, and any purpose of the partnership inferable therefrom changed; for within three months after the acquisition of the property by the partnership there ensued between the two entities the breach above referred to which was never healed; as a result thereof the partnership completely disengaged itself from any liability for, or gain from, the activities of Lake Murray; and before the sale involved here by Freeland of his interest in the partnership Lake Murray had failed and gone completely out of existence; and (4) the gain of Freeland on that sale was due in fact to appreciation in value of the land, resulting from the rapid and accelerating growth of San Diego.

ARGUMENT.

I.

Neither the Tax Court's Own Findings, nor Anything in the Evidence, Gives Either Form or Substance to the Tax Court's Imputation of the Activities of Lake Murray Development Company to the Partnership, Sam Berger Investment Company.

The conclusion of the Tax Court here approving the Commissioner's determination of deficiencies results from its agreement with the Commissioner that the purpose for which the partnership, Sam Berger Investment Company, held its property, vacant land, was sale thereof to customers in the ordinary course of trade or business, and that that was the purpose for which the partnership held the property at the time when Freeland sold his interest in the partnership. The Tax Court concedes, however, the complete absence, at any time at all, from the activities of the partnership, of the "normal criteria" of such a purpose for holding property, such as advertising, solicitation, or any other efforts to sell, or actual sales which it had a choice to make or not to make. [TC 33.] It relies instead on imputation to the partnership of the activities of another entity, Lake Murray Development Company; and it concedes that if it did not rely on that imputation its conclusion would be different. [TC 32-33.]

How the Tax Court reaches such imputation is also significant. It makes no attempt to tie the two entities together by showing, which it could not, or even stating, that there was common control, as by the same persons controlling both entities, or one of the entities con-

trolling the other, as the taxpayers controlled the developing entity in *Ackerman v. U.S.* (C.A. 5, 1964), 335 F. 2d 521, and *Todd Tibballs v. U.S.* (Ct. Cls., 1966), 362 F. 2d 266. What the Tax Court relies on here to tie the two entities together is what it characterizes as "interlocking participations" between them [TC 29-30], the fact that they had certain "common participants" [TC 31], that the partners of the partnership "were deeply involved" in the activities of Lake Murray. [TC 33.]

What the Tax Court's opinion attempts in this vague and speculative manner is to engraft upon its findings an assumption or gloss of common control, and this in conflict with those very findings. If the two entities were under such control, no clash between them could have occurred. As shown in the Statement above, on the basis of the findings and the stipulated exhibits, a breach between the two entities developed within three months after the agreement between them was signed. That agreement was not merely amended as a result to eliminate "disputes arising out of the working relationships" between the two entities, as the opinion of the Tax Court attempts to explain [TC 30]; the amendments completely disengaged the partnership from any responsibility for, or any gain from, the activities of Lake Murray. Thus any thesis of common control of Lake Murray and the partnership is wholly without substance, is on the contrary in conflict with the court's own findings.

In the same connection the Tax Court finds suspicious the price of $2,000.00 per acre charged Lake Murray, while the average price to the partnership was only $1,037.00 per acre. [TC 30.] But as the Tax Court

found, the 4500 acres contained a lake, some canyons, and a mountain 1100 feet high. [TC 5.] The attempt by Berger to obtain substitution of land in the foothills of the mountain ran into the obstacle of prohibitive off-site improvement cost. Also, when a large tract is divided into lots or other pieces, the price per acre for a piece is higher than the price per acre of the entire tract. See *Todd Tibballs, supra,* at page 270. Obviously, then, the average price of the 4500 acres could hardly be a basis for a reasonable price per acre for the 500 acres. There is nothing then to support the Tax Court's vaguely and laboriously framed assumption of common control. It conflicts instead with the court's own findings.

Thus the Tax Court's attempt to tie the two entities together, by the "interlocking" relation upon which its imputation to the partnership of the activities of Lake Murray, by its own terms, depends, does not hold.

II.

The Statute Speaks Only of the Holding of Property for Sale to Customers; but as Shown by the Tax Court's Own Findings, the Partnership Never Made a Single Sale of Any Property Held by It in Respect to Which It at Any Time Had a Choice to Make the Sale or Not to Make It.

It is obvious that property is not held for sale to customers in the ordinary course of trade or business unless it is held for sale; and before it can be held by the taxpayer for sale it must in fact be *held* by the taxpayer, and the taxpayer must have a right to sell it, or not to sell it.

This certainly was not true of the 500 acres subject to Lake Murray's option. From the moment the partnership acquired the property it was subject to that option; and the partnership had to make it subject to that option in order to get the $200,000.00 deposit required to complete the acquisition. Thus it had no choice but to make the sales to Lake Murray. As to the sales by the partnership out of property not subject to the option there was not a single one of which this was not also true—not a single one, not even one, the partnership was not required to make or could not have been required to make. Any offers by others were refused. There was no listing, no solicitation of purchasers, directly or indirectly. It follows that the Tax Court's conclusion was based only on representations of plans before the partnership acquired the property, and such representations by Lake Murray afterwards, none of which reached fruition. It was not based on any holding of the property—any kind, form, or manner of actual holding of the property—by the partnership.

But, again, the statutory provision involved speaks only of the *holding* of property for sale to customers in the ordinary course of trade or business. It does not speak of a dream of such holding before the property is actually held, and certainly not of such a dream which never reaches reality.

III.

The "Interlocking" Relation Between the Partnership and Lake Murray Upon Which the Tax Court Relies, Assuming It Had the Substance and Effect Which the Tax Court Attributes to It, Came to an End More Than a Year and a Half Before the Sale Involved Here by Freeland of His Interest in the Partnership.

The Tax Court, citing *Todd Tibballs v. U.S., supra,* recognizes that a change of purpose can take place after acquisition. Assuming then that the partinership, after it acquired the property, had a purpose, which the Tax Court derives solely from the "interlocking" relation with Lake Murray [TC 29, 29-30, 32-33], to hold the property for sale to customers in the ordinary course of its trade or business, the question is whether that purpose still existed at the time Freeland sold his interest to the Tavares group.

In this connection it must be borne in mind that a parcel of land is not the same as an inventory of shirts or automobiles. It is normal to hold land for investment. A parcel of land may be held for investment even by a person in the real estate business. Indeed, a particular piece of real estate can even be held for investment by one holding other pieces of the same tract for sale to customers in the ordinary course of trade or business. *Todd Tibballs v. U.S., supra,* at p. 271; *Scheuber v. Commissioner* (C.A. 7, 1967), 371 F. 2d 996. The reason is the propensity of land, because of increase or influx of population or enterprise, to

increase in value without any activity on the part of the holder. In this respect real estate has a very special character.

Now looking at the history of the property involved here we find that a radical change took place after the property was acquired. Early in 1955, within three months after the option agreement was executed between the partnership and Lake Murray, differences arose between them. The partnership, then guarantor of the off-site improvement costs incurred by Lake Murray, disputed the propriety of the work being done and filed notices of non-responsibility for such costs. By the middle of 1955, as observed under point 1 above, the agreement between them was amended so as to eliminate every aspect of responsibility and gain of the partnership in respect of the development work on the property. By that time also Lake Murray was in financial difficulties, from which it did not recover. By May, 1956, it had become insolvent and its activities came to an end.

Somewhat the same situation appears in *Todd Tiballs v. U.S., supra.* There two brothers, sole owners of several development corporations, had acquired a tract previously subdivided into some 435½ lots. They submitted to the city a proposal for water, sewer and street improvements, which was approved. In 1951 they sold two lots to one of the development corporations; it built experimental houses on them. In 1952 they sold 100 lots to another of these corporations; that corporation proceeded to build houses on about 60 of the lots; then it sold the other 40 lots to other corporations, one controlled by them and two uncontrolled. Finally, in 1952, the brothers sold the remaining 333½ lots in

a single sale to an outside builder. As to the 102 lots the Court of Claims decided they were held by the brothers for sale to customers in the ordinary course of their trade or business; as to the 333½ lots it concluded that they were not so held and were therefore capital assets.

The court there found (p. 272) that the development activities, including the water, sewer and street improvements, had been narrowed down to the 102 lots, as here such improvements were limited to the 500 acres. The court there also found (p. 270), as to the other 333½ lots, that, as here in the case of the 4000 acres not subject to Lake Murray's option, there were no signs or listings and they had refused offers for the individual lots. The court there also found (pp. 270, 272), as here, that the portion of the tract developed was not doing well, and that there was no further development activity. From this the court there (p. 272) inferred that if the brothers there had originally intended to develop or retail all of their 435½ lots they had given up that intention and had contented themselves with the 102 lots previously sold by them. The court there then observed (p. 273) that a taxpayer's purpose can change, and it is his purpose "during the period prior to the sale which is critical." The court by inference from the circumstances above stated concluded that the purpose had indeed changed, that it had become "the realization of appreciation in value accrued over a substantial period of time," as quoted from *Commissioner v. Gillette Motor Transportation, Inc.*, 364 U.S. 130, 134, 86 S. Ct. 1497, 1500, rather than profits "arising from the everyday operation of a business," as quoted from *Corn Products Refining Co. v. Commis-*

sioner, 350 U.S. 46, 52, 76 S. Ct. 20, 24. The Court of Claims therefore, as above noted, allowed capital gain on the 333½ lots.

The situation here, indeed, is even clearer. Here the property-owning entity had no such control as there of the development entity. The Tax Court here relied upon "interlocking" of the entities, based upon, not actual control of the one entity by the other, or actual common control of both entities, but only certain "common participants," however they participated, and this in the face of a bitter breach never healed between the two entities. Here also the development entity failed altogether and the "interlocking" of the two entities, such as it was, and it is entirely upon that that the Tax Court here relied, came to an end. Actually it came to an end in February, 1955, when the notices of non-responsibility were filed; certainly at least by July, 1955, when the amended agreement was executed. Of course, by no means could it be said to exist after Lake Murray's activities came to an end, in May, 1956. To say that no change occurred would be to deny the Tax Court's own findings. Following *Todd Tibballs v. U.S., supra,* it is clear here, assuming the partnership was ever tainted by Lake Murray's purposes, and, if it was, assuming further that that taint had any substance beyond the 500 acres subject to Lake Murray's option, assuming both of those necessary elements, the taint was completely washed out by the early rupture between the two entities, and not even the imagination could conjure it up after Lake Murray's activities had come to an end.

IV.

The Gain of Freeland on the Sale by Him of His Partnership Interest Was in Fact Due to the Appreciation in Value, of the Land Held by It, as a Result of the Rapid and Accelerating Growth of San Diego.

It is said that the proof of the pudding is in the eating. The findings show clearly as the cause of the gain involved here, the rapid, accelerating growth of San Diego and the resultant appreciation in its real estate values. During the very years involved here some 1300 adjoining acres being developed by other builders were dong well. And we have here the testimony of the largest developer in the area, and the one who purchased the property, that the proof of the appreciation in value was what he paid for it. Thus the gain was due in its entirety to appreciation, and that is exactly what the capital gain rates are for. *Commissioner v. Gillette Motor Transportation, Inc., supra; Todd Tiballs v. U.S., supra.*

Conclusion.

Petitioners submit in conclusion that the decision of the Tax Court herein should be reversed.

Respectfully submitted,

GEORGE T. ALTMAN,
Attorney for Petitioners.

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

George T. Altman